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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1937

No. 287

EDWARD McLOUGHLIN, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 5, 1937.

CERTIORARI GRANTED OCTOBER 11, 1937.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

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COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., OCTOBER 20, 1937.

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[fol. 1]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 80,484

EDWARD McLOUGHLIN, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DOCKET ENTRIES

Appearances:

For Petitioner: Bernhard Knollenberg, Harry J. Rudick, Joseph W. Wyatt.

For Commissioner: James H. Yeatman, Esq.

1935.

June 13. Petition received and filed. Taxpayer notified. (Fee paid.)

" 13. Copy of petition served on General Counsel.

Aug. 10. Answer filed by General Counsel.

" 15. Copy of answer served on taxpayer.

Sept. 14. Hearing set October 21, 1935.

Oct. 17. Motion to adjourn hearing to October 28, 1935, filed by taxpayer. October 18, 1935, granted.

Oct. 28. Hearing had before Mr. C. R. Arundell, Division 7. Submitted on the merits. Stipulation of facts and appearance of Mr. Wyatt, filed. Petitioner's brief due November 30, 1935. Respondent's December 14, 1935. Petitioner's reply due January 2, 1936.

[fol. 2]

Nov. 2. Transcript of hearing October 28, 1935, filed.

" 13. Brief filed by taxpayer. November 13, 1935, copy served.

Dec. 31. Motion for leave to file brief. Brief lodged, filed by General Counsel. January 3, 1936, granted.

1936.

Jan. 3. Order that time for respondent's brief be extended to January 3, 1936, and that time for Petitioner's brief be extended to January 23, 1936, entered.

" 30. Motion for leave to file reply brief *reply brief* lodged, filed by taxpayer.

" 31. Motion for leave to file reply brief granted.

DOCKET ENTRIES—Continued

1936.

Feb. 4. Copy of motion and reply brief served.
Aug. 19. Findings of fact and opinion rendered, Mr. C. R. Arundell, Division 7. Decision will be entered for respondent.
" 21. Decision entered, C. R. Arundell, Division 7.
Sept. 17. Motion for rehearing or reconsideration filed by taxpayer. September 24, 1936, denied.
Oct. 13. Petition for review by United States Circuit Court of Appeals, Second Circuit, with assignments of error filed by taxpayer.
" 13. Proof of service filed by taxpayer.
" 13. Præcipe filed.
" 13. Proof of service of præcipe filed.

[fol. 3] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

PETITION—Filed June 13, 1935

The above named Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:AR:A-1, LWB-90D), dated March 15, 1935, and as a basis for his proceeding alleges as follows:

1. The Petitioner is an individual residing at 361 First Street, Brooklyn, New York.

2. The notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was dated and presumably was mailed to the Petitioner on March 15, 1935.

3. The taxes in controversy are income taxes for the year 1932 in the sum of $224.09.

4. The determination of tax set forth in said notice of deficiency is based upon the following error:

[fol. 4] Inclusion in the Petitioner's gross income for the year 1932 of the sum of $5,125 received by him as an employee of the State of New York, whereas Petitioner maintains that he is exempt from federal income tax on this compensation because it is compensation received by him for his services as an employee of the State.

5. The facts upon which the Petitioner relies as a basis of this proceeding are as follows:

Petitioner is an employee of the Insurance Department of the State of New York. He devotes, and throughout the year 1932 devoted, his entire time to the work of this Department. The entire amount in question was received by him as compensation for this work.

Wherefore, the Petitioner prays that this Board may hear the proceeding and redetermine the deficiency alleged by the Respondent herein.

(S.) Bernhard Knollenberg, Harry J. Rudick, Counsel for Petitioner, 25 Broadway, New York, New York.

Duly sworn to by Edward McLoughlin. Jurat omitted in printing.

[fol. 5] EXHIBIT "A" TO PETITION

Treasury Department, Washington

Office of Commissioner of Internal Revenue

March 15, 1935.

Mr. Edward McLoughlin, 361 First Street, Brooklyn, New York.

SIR:

You are advised that the determination of your income tax liability for the year 1932 discloses a deficiency of $224.09 as shown in the statement attached.

In accordance with section 272 (a) of the Revenue Act of 1932, as amended by section 501 of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. [fol. 6] Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period termi-

nates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully, Guy T. Helvering, Commissioner, by
(Signed) Chas. T. Russell, Deputy Commissioner.

Enclosures: Statement, Form 870.

[fol. 7] Statement

IT:AR:A-1.
LWB-90D.

In re Mr. Edward McLoughlin, 361 First Street, Brooklyn, New York

Income Tax Liability

Year	Income Tax Liability	Income Tax Assessed	Deficiency
1932	$224.09	none	$224.09

An examination of your income tax return for 1932 reveals that you received compensation from the State of New York Insurance Department amounting to $5,125.00, which was not included as taxable income.

The Bureau holds that where liquidators are engaged to render services in connection with the liquidation of a bank by the Banking Department of a state and their compensation is paid from funds or assets of the bank being liquidated, such compensation must be included in gross income for Federal income tax purposes. (See G. C. M. 13488, published in Internal Revenue Bulletin XIII-35, page 9.)

The revised computation of your income tax liability is shown below:

Net income shown on return	$676.18
Add:	
Compensation	5,125.00
Net income revised	$5,801.18
[fol. 8] Less:	
Personal exemption	1,000.00
Balance subject to normal tax	$4,801.18
Normal tax at 4% on $4,000.00	$160.00
Normal tax at 8% on $801.18	64.09
Income tax liability	$224.09
Income tax assessed	none.
Deficiency	$224.09

Due to the fact that the statute of limitations will presently bar any assessment of additional tax against you for the year 1932, the Income Tax Unit will be unable to afford you an opportunity to discuss your case before mailing formal notice of its determination as provided by section 272 (a) of the Revenue Act of 1932, as amended by section 501 of the Revenue Act of 1934. It is, therefore, necessary at this time to issue this formal notice of deficiency.

[fol. 9] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

ANSWER—Filed August 10, 1935

The Commissioner of Internal Revenue, by his attorney, Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue, for answer to the petition filed by the above-named taxpayer, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. Denies the errors alleged in paragraph 4 of the petition.

5. Denies the material allegations of fact set forth in paragraph 5 of petition.

Denies generally and specifically each and every allegation contained in the taxpayer's petition not hereinbefore [fol. 10] admitted, qualified or denied.

Wherefore, it is prayed that the taxpayer's petition be denied.

(Signed) Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue. Of Counsel: James H. Yeatman, Special Attorney, Bureau of Internal Revenue.

JHY/nc 8/9/35.

BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

STIPULATION OF FACTS—Filed October 28, 1935

The parties to the above-styled proceeding, by their respective counsel of record, hereby stipulate and agree [fol. 11] that the following facts are true:

1. The petitioner is an individual and resides at 361 First Street, Brooklyn, New York. He filed his income tax return for 1932 with the Collector of Internal Revenue for the First District of New York, whose office is located at Brooklyn, New York.

2. The taxes in controversy are income taxes for the calendar year 1932 and the amount of the deficiency determined by the respondent for such year is $224.09. On his return for the calendar year 1932 the petitioner reported that he had received a salary of $5,125.00 during said year from the New York State Insurance Department but claimed the amount as a deduction under Item 18 of the return. In the deficiency letter on which this proceeding is based Respondent held that the compensation of $5,125.00 is subject to Federal income tax. The only question for determination by the Board in this proceeding is whether said income is taxable.

3. The petitioner is an attorney at law. Prior to 1929 he was associated with the law firm of Richards, Smyth and Conway, 32 Court Street, Brooklyn, New York, and was actively engaged in the practice of law with such firm. In 1929 the petitioner was appointed Secretary to the then Superintendent of Insurance of the State of New York and he occupied this position for approximately six months. In 1930 he was requested by the Superintendent of In- [fol. 12] surance to act as counsel in the Liquidation Bureau, a branch of the Insurance Department. He performed these duties from the beginning of 1930 to and until August 2, 1933. During the year 1932 the Liquidation Bureau maintained three offices in New York. The main office was in the State Building at 80 Center Street, where petitioner was employed during 1932, and there were two branch offices, one at 2 Lafayette Street, and the other at 111 John Street, New York, New York. The petitioner

gave full time required of employees in the Liquidation Bureau, and his hours were from 9 A. M. to 5 P. M., the same as other attaches of that Bureau who were not engaged in legal work.

4. After severing connections with the law firm with which he was connected in 1929 petitioner received no further salary from said firm. He maintained office space in the office of said firm and did a certain amount of personal legal work such as the preparation of wills, et cetera, all of which was accomplished out of his regular hours. In doing this personal work petitioner would get the assistance of one of the members of the law firm to handle or cooperate in the same, and the amount of any fees resulting therefrom would be divided according to mutual agreement with such individual. Petitioner's personal legal fees in 1932 amounted to $1,410.00 and his office expenses were $570.00. The greater part of such sum represented fees from matters commenced in 1929, prior to his association with the Insurance Department. None of the personal legal work which he obtained after becoming associated with the insurance Department was the result, [fol. 13] either directly or indirectly, of such association.

5. The liquidation Bureau was created in 1909 and is now known as the Bureau of Liquidations, Conservations and Rehabilitations. This change in designation occurred sometime in 1933 and was made to make the name of the Bureau conform to the description of the title of Article 11, Chapter 191, of the Insurance Laws of the State of New York, which went into effect on March 15, 1932. For the sake of brevity the Liquidation Bureau (known as Bureau of Liquidations, Conservations and Rehabilitations after 1933) will be hereinafter referred to as the Bureau. The Bureau was in the year 1932 and now is in charge of a Special Deputy Superintendent of Insurance. Said Deputy Superintendent is a Civil Service employee of the State of New York, and his salary is paid directly by the State. The Bureau also had in 1932 three assistant Special Deputy Superintendents, attorneys working on legal matters, bookkeepers, stenographers, adjusters and accountants. At the beginning of 1932 the Bureau had approximately 100 employees and at the end of 1932 the number had been increased to approximately 400. None of said persons, with the exception of the Special Deputy Superin-

tendent in charge, were Civil Service employees. The number of employees varies according to the number of insurance companies under the Bureau's jurisdiction.

6. The general functions and duties of the Bureau are as follows: Under the Insurance Laws of the State of New [fol. 14] York the Superintendent of Insurance of that State may, on certain grounds, apply to the judicial authorities of the State for an order directing him to take over the assets of insurers doing business or in process of organization for the purpose of doing business in such State, for the purpose of liquidating, rehabilitating or conserving the business of such insurers. Upon an order directing rehabilitation, liquidation or conservation being granted, all of the work necessary to accomplish any of these results is performed by the Bureau. When an order is obtained directing the liquidation of an insurance company its charter is dissolved and no new business is transacted. The work of liquidation consists of adjudicating the claims of the creditors of the company, selling the real estate and the other assets and attempting to collect premiums due. After all of the assets of a company have been realized upon, dividends are distributed pro rata to the claimants entitled under the laws of the State of New York to participate in the assets of a defunct insurance company. Of the assets available for distribution of insolvent companies the proceeds of liquidation first go to the payment of claims of creditors who have claims under policies or bonds issued by the insurer prior to the time that the Superintendent took over the affairs of the company for the purpose of liquidation. Any money left over after the payment to creditors is first used for the purpose of refunding the paid-in premiums and if any balance is left it is distributed to the stockholders of the company. It is only in exceptional cases that stockholders have recovered anything. There is attached hereto and made a part hereof as Exhibits A and [fol. 15] B, statements showing the companies being liquidated by the Bureau and certain data concerning same as of January 1, 1932, and December 31, 1932. When an order is obtained directing the rehabilitation of an insurance company the Bureau actively operates it (but conducts no new business) and takes steps to remove the causes and conditions which made such proceeding necessary in an effort to bring about its rehabilitation and place the company in

a sound financial condition. If the Bureau succeeds in rehabilitating the insurer, the assets are turned back to it and it resumes operations under its own direction. If and when it is determined that further efforts to rehabilitate a company will be futile the Superintendent of Insurance may apply for an order of liquidation. No rehabilitation work was done by the petitioner or the Bureau in 1932. Although the Superintendent of Insurance was authorized to apply for rehabilitation orders, no such order was applied for until the year 1933. When an order is obtained directing the Superintendent to take over the assets of a foreign insurer for the purpose of conservation, the Bureau proceeds to collect the assets and conserve them for the benefit of policy holders and others to whom the company is obligated. In a conservation proceeding the Bureau acts much in the same manner as the ancillary receiver of a foreign corporation. The major portion of the work of the Bureau consists of liquidating insolvent insurers doing business in the State of New York. Upon taking charge of a company for liquidation purposes certain of the staff of the company such as underwriters and the so-called "production staff" would be dismissed. The key employees would [fol. 16] be retained, and the remainder dismissed as soon as practicable. It was the policy of the Bureau to centralize the liquidation work as much as possible in one office. The procedure would necessarily vary according to the size of the companies placed in liquidation, etc. In the case of a very large company its affairs could not be transferred to another office for a long period of time.

7. In legal matters involving companies in liquidation, the petitioner appeared as the attorney of record. He devoted over 90% of his time during 1932 to legal problems and cases involving the companies in liquidation whose affairs were being administered at the 80 Center Street office. The balance of his time was devoted to legal problems of the Bureau as a whole, such as the drafting of a new Article XI of the Insurance Law.

8. In the year 1932 the Department of Insurance had a general bank account with the Bank of New York & Trust Company at 48 Wall Street, New York City. The expenses of the Bureau, including all salaries, were paid by checks drawn on this bank. This account was referred to as the "Wash Account," as simultaneously with the drawing of

checks for salaries, etc., other checks were drawn on the bank accounts of the companies in liquidation and deposited with the Bank of New York & Trust Company to equalize the amount drawn out therefrom to meet the salaries and other overhead expenses of the Bureau. In drawing checks against the various companies in liquidation to meet [fol. 17] petitioner's compensation and the other expenses of the Bureau, checks would be drawn by an Assistant Special Deputy of Insurance (as representative of the Superintendent of Insurance) on the bank accounts in which the deposits of the various companies were maintained. Each company coming under the jurisdiction of the Bureau kept its separate bank account, and the Superintendent of Insurance (having charge of all the assets of such company) was in a position to draw checks on the account.

9. Petitioner's compensation for 1932 was prorated to the companies in proportion to the time devoted by him in connection with the respective companies on the legal affairs of which he was engaged. Petitioner's time devoted to the affairs of one particular company, would be charged against such company. Petitioner's time devoted to the general legal problems of the Department, would be prorated among the various companies under a formula designed to charge general administration expenses of the Department to the companies in liquidation in proportion to the aggregate compensation of those engaged in the specific liquidation of the respective companies.

10. Petitioner's compensation during 1932 was paid bimonthly but was computed on an annual basis. Petitioner was paid by check, a form of the check used being annexed hereto as Exhibit "C." Petitioner did not receive any additional compensation from the Insurance Department by way of special fees or otherwise in addition to his fixed compensation. His yearly compensation was determined by the Superintendent and the compensation did not vary [fol. 18] in accordance with the volume of legal matters handled by him during the year. Petitioner's entire compensation for 1932 was paid from funds of insurance companies being liquidated by the Superintendent of Insurance.

11. In the budget of the Superintendent of Insurance there appeared an item called the Reserve Fund, for the use of the Superintendent in liquidating insurance compa-

nies whose assets were not sufficient to pay the costs of liquidation. In the budgets submitted for the fiscal years ending June 30, 1931, 1932 and 1933, the amount of the Reserve Fund was $5,000.00. It does not appear that any of the compensation paid to the petitioner during the year 1932 was derived from this fund.

Bernhard Knollenberg, Counsel for Petitioner. Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue, Counsel for Respondent.

(Here follows 4 photos, side folios 19 to 22)

TABLE E — PART II

Liquidation Proceedings Pending January 1, 1932 — Transferred to Closed and Inactive Proceedings During the Year 1932

Name of Company	Principal office	Proceedings commenced	Realized on assets	Total liabilities		Disbursements for liquidation expenses, taxes and for conservation of assets	Distributed to: Preferred and secured creditors (paid in full)	Distributed to: Other creditors	Distributed to: Members or stockholders	Per Cent of Distribution: Other creditors	Per Cent of Distribution: Members or stockholders	Assets Undistributed: Cash	Assets Undistributed: Other assets (book value)
	B	C	D	E		F	G	H	I	J	K	L	M
General Corporations													
1. Allied Automobile Owners Association, Inc. ■	Brooklyn	April 8, 1930	$1,094 80	$3,422 43	1.	$780 65		$342 84		7		$10 16	
2. Interstate Reciprocation Corporation ■	Brooklyn	April 30, 1930	347 43		2.	332 99						14 43	
Life, Health and Casualty Insurance Corporations													
3. Brooklyn Taxpayers Association, Inc. ◆	New York	July 10, 1929	25,014 15	13,543 62	3.	4,949 53	$1,295 26					18,769 26	
4. Columbia Life Assurance Society ■ **	New York	June 27, 1911	4,749 76	1,745 60	4.	2,404 76	1,745 60					599 37	
5. Interborough Taxpayers Protective Ass'n, Inc. **	New York	July 20, 1929	13,889 16	5,479 77	5.	3,986 97	281 33	5,195 44		100 with int.		6,422 42	
Fire Insurance Corporations													
6. Consolidated Assurance Company, Ltd., U. S. Branch **	New York	Oct. 14, 1926	239,945 73	80,205 11	6.	11,955 24	47,485 28	2,719 82		100 with int.		42,785 38	*$100,000 00
7. Monroe Fire Insurance Co. of Monroe, U. S. Branch ■	New York	Aug. 8, 1925	767,859 39	661,397 55	7.	97,639 50	29,670 30	633,327 25		100 with int.		*8,522 25	*1,098,500 00
8. Nordia Lloyd Insurance Company, Ltd., U. S. Branch ■ **	New York	May 3, 1922	3,360,751 64	154,460 68	8.	289,152 79	115,268 90	809,555 04		100 with int.		2,229 55	
9. Northern Insurance Company, Monroe, U. S. Branch ■	New York	June 6, 1926	489,289 38	134,102 00	9.	*95,546 37	65,020 54	20,251 14		100 with int.		*33,348 60	*200,000 00
10. Queens, Suffolk Mutual Fire Ins. Corp. of L. I. ■	Prospect	Jan. 8, 1925	4,346 00	381 53	10.	230 15	31 53	350 00	$1,371 22	100	18 83	2,343 19	
11. Russian Reinsurance Company, U. S. Branch ■ **	New York	Aug. 8, 1925	980,688 68	251,440 25	11.	84,087 34	45,242 80	176,077 44		100 with int.		2,454 06	*191,825 09
12. Second Russian Insurance Company, U. S. Branch ■ **	New York	May 22, 1925	1,364,572 64	1,082,501 10	12.	*165,902 13	55,898 51	1,026,902 50		100 with int.		1,223 56	
Marine Insurance Corporations													
13. Jewelers Safety Fund Society ■	New York	Oct. 13, 1927	515,912 13	283,750 29	13.	94,467 18		283,750 29	159,775 62	100 with int.		7,919 04	*14,071 78
14. Liberty Marine Insurance Company **	New York	Feb. 14, 1931	922,634 29	973,981 73	14.	120,806 22	151,929 10	627,491 18		75 —	100	22,268 81	
15. North Atlantic Insurance Company **	New York	Feb. 14, 1931	969,457 66	967,991 05	15.	137,821 04	163,177 33	653,849 04		75		14,439 67	
Title and Credit Guaranty Corporations													
16. North American Title Guaranty Company **	New York	Aug. 26, 1930	288,023 00	103,315 73	16.	53,518 00	73,202 51	7,109 77		25		70,433 16	15,500 00
17. Onondaga Guaranty and Title Company ■	Syracuse	Sept. 9, 1932	225,506 00	302 96	17.	472 21	302 96		221,839 61		147 83	3,000 00	
Mutual Employers' Liability and Workmen's Compensation Corporations													
18. Empire State Mutual Insurance Company ◆ **	New York	Oct. 9, 1929	458,634 49	15,434 50	18.	27,581 86	42,774 60					26,080 94	11,057 93
Life or Casualty Insurance Corporations upon the Cooperative or Assessment Plan													
19. Protective Life Assurance Society ■	Buffalo	Feb. 7, 1917	27,486 42	23,511 82	19.	3,222 19		23,511 82		100 with int.		721 41	
20. Scandia Life Insurance Society ■	New York	Nov. 17, 1930	84,633 40	18,054 92	20.	4,619 29		18,054 92	60,000 00	100 with int.		1,393 19	

■ — Proceedings completed.
◆ — Final distribution withheld pending confirmation of reports filed with Supreme Court of New York County.
4 ** — Further distribution, if any, dependent upon amount received from auction sale of Ward's Island property.
5 ** — Final distribution withheld pending determination of liability for Federal and State taxes.
6 ** — Final distribution withheld pending determination of liability on claim now pending before Supreme Court of New York County. — $116,000.30 transmitted to British Liquidator.
8 M* — Held by State of Ohio.
9 L.* (M*) — Available for distribution, less reserves for two claims not adjudicated and further expenses of liquidation
9 ** — Payments of $2,142,930.36 made to Norwegian Liquidator.
10 F* — In addition $92,383.18 paid for legal services out of surplus assets pursuant to order of Supreme Court.
10 L.* (M*) — Available for distribution, less further expenses of liquidation.

11 **— Surplus assets of $332,000.00 in securities and $353,106.91 in cash were turned over to Company.
11 M* — Held by State of Ohio.
12 F* — In addition $51,723.72 paid for legal services out of surplus assets pursuant to order of Supreme Court.
12 ** — $100,000.00 in securities constituting deposit with State of Ohio transmitted directly to assignee by the State of Ohio Insurance Department. $14,855.68 paid to Bank of Manhattan Company, as assignee.
13 M* — Further distribution withheld pending possible additional recoveries from members included in this amount.
14 ** — Further distribution withheld pending determination liability for Federal and State taxes.
14 M* — Other assets consist of claims against Receiver of Hanover & Company and of salvage claims.
15 M* — Final distribution withheld pending determination of two claims disallowed by Liquidator and appealed by claimants.
16 ** — $304,217.00 turned over to Utica Mutual Insurance Company pursuant to reinsurance agreement dated October 18, 1930.
20 K* — Distribution to members on old account at rate of 10.26% and on new account at rate of 42.3%

EXHIBIT "A" TO STIPULATION

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EXHIBIT A (CONT'D.)

TABLE E — PART II — (Continued)

LIQUIDATION PROCEEDINGS PENDING JANUARY 1, 1932 — TRANSFERRED TO CLOSED AND INACTIVE PROCEEDINGS DURING THE YEAR 1932 — (*Concl'd*)

Name of Company	Principal office	Proceedings commenced	Realized on assets	Total liabilities	Disbursements for liquidation expenses, taxes and for conservation of assets	Distributed to: Preferred and secured creditors (paid in full)	Distributed to: Other creditors	Distributed to: Members or stockholders	Per Cent or Distribution: Other creditors	Per Cent or Distribution: Members or stockholders	Assets Undistributed: Cash	Assets Undistributed: Other assets (book value)
	B	C	D	E	F	G	H	I	J	K	L	M
Fraternal Benefit Business												
21. Sub Pelagian Sign [illegible]	[illegible]	Feb. 26, 1921	$927,989 16	$999,422 30	21. $22,234 72	$3,615 20	$220,200 21		80.85		$1,310 97	
22. United Sickly Grand Lodge of the Order Ralph Abaloo **	New York	Dec. 21, 1927	43,289 20	50,327 99	22. 6,300 20	6,336 61	38,023 66				177 92	
Cooperative Fire Insurance Corporations												
23. Fidelity Cooperative Fire Insurance Company [illegible]	Alfred	April 17, 1922	155,288 15	130,346 93	23. 24,927 19		130,346 93		100 with int.		114 42	
Lloyds and Inter-Insurers												
24. Liberty Underwriters of New York **	New York	Feb. 2, 1929	27,731 84	27,474 33	24. 11,577 02	2,399 17	13,857 39	A	50.		1,306 97	$97,420 84
Mutual Automobile Fire Insurance Corporations												
25. Automobile Motors Prefabricated Mutual Fire Ins. Company **	New York	Mar. 28, 1929	1,250 95	2,000 97	25. 600 21	694 19					300 85	
26. Motor Car Mutual Fire Insurance Company **	New York	Mar. 7, 1922	40,735 31	37,326 98	26. 34,986 51	1,699 41	13,779 79		50.		1,419 80	
Mutual Automobile Casualty Insurance Corporations												
27. City Service Mutual Casualty Corp. ◆	New York	Dec. 15, 1925	259,563 97	454,522 39	27. 69,302 52	7,139 02	134,301 07		30.		49,907 48	
28. Fifth Avenue Mutual Indemnity Company ◆	New York	April 19, 1926	310,446 68	391,562 23	28. 53,517 72	3,702 04	115,309 19		40.		35,926 89	
29. Lincoln Auto Mutual Casualty Corp. **	New York	Nov. 20, 1927	176,622 68	235,744 68	29. 61,657 27	694 51	110,588 23		34.		4,102 67	
30. Motor Car Mutual Casualty Company **	New York	Mar. 7, 1922	299,329 65	178,516 65	30. 84,878 65	8,730 45	173,056 60	$97,000 00	100 with int.	32.49	1,944 33	
31. Mutual Automobile Liability Insurance Company ** ◆	New York	Oct. 25, 1922	35,755 73	17,304 48	31. 14,006 52	699 57	10,813 11	4,496 36	100 with int.	100 with int.	297 84	
32. National Automobile Mutual Casualty Company ◆	New York	June 23, 1923	306,194 19	177,853 34	32. 102,483 33	32,917	144,905 67		100.		104,858 42	1.
33. New York Mutual Casualty Insurance Corp. ◆	New York	Feb. 23, 1926	79,728 88	260,335 39	33. 23,637 19	1,570	28,886 95		50.		18,919 68	
34. Standard Automobile Mutual Casualty Company ◆	New York	April 5, 1923	171,648 65	125,399 10	34. 77,666 39	11,992 35	62,343 13		60.		13,545 13	102.75
35. Twentieth Century Mutual Auto. Cas. Insurance Co. ◆	New York	Nov. 21, 1925	302,795 72	257,462 88	35. 84,686 41	699 20	102,641 79		40.		69,686 32	
36. U. S. Mutual Automobile Casualty Company **	New York	Sept. 26, 1921	139,738 37	30,000 82	36. 41,876 55	4,226 62	16,274 98	30,000 00	100 with int.	75.65	8,361 88	
37. World Mutual Casualty Company ◆	New York	June 23, 1924	227,314 47	139,304 84	37. 113,713 84	31,994 36					93,907 37	
Fire and Marine Insurance Corporations												
38. Spike-American Fire & Marine Insurance Company [illegible]	New York	Jan. 26, 1931	10,391 83	5,334 67	38. 3,772 36		5,334 67	729 42	100 with int.	3.	55 44	
Miscellaneous												
39. Commeyenne's Mutual Aid Society [illegible]	New York	Mar. 31, 1931	66,662 33	888 41	39. 3,173 89		888 41	60,337 75	100 with int.	92.69	867 64	

** — Further distribution contingent upon amount received from sale of equality plots, only remaining assets.
24 ◆ — Dividends paid on disability claims 4.286%, other claims 24.57%.
26 ** — Additional distribution contingent upon further collections on subscription notes of underwriters.
29 ** — Negotiations pending with officers of this corporation to pay all claims in full.
30 ** — Additional distribution contingent upon further collection of assessment.
32 ** — Further distribution withheld pending determination of liability for State taxes.
33 ** — Final distribution withheld pending confirmation of reports of Referee.
36 ** — Final distribution of assessment deposit to members withheld pending sale of judgments.

20

TABLE E — PART III

LIQUIDATION PROCEEDINGS PENDING ON DECEMBER 31, 1932

Name of Company (A)	Principal office (B)	Statement of Condition as Last Reported (Prior to Liquidation) — Assets: Admitted (C)	Assets: Non-admitted (D)	Liabilities (except capital) (E)	Proceedings commenced (F)	Disposition of Claims Filed: Allowed (G)	Disallowed (H)	Suspended (I)	Disbursements for liquidation expenses, taxes and for conservation of assets (J)	Payments Made: Preferred and secured creditors (paid in full) (K)	Other creditors (L)	Per cent of claims paid to other creditors (M)	Assets Undistributed: Cash (N)	Other assets (book values) (O)
1. Acro Indemnity Company	New York	$2,252,708 92	$114,082 22	$208,514 79	Nov. 22, 1932	*	*	*	$378 50				*$968 43	$439,223 95
2. Acro Insurance Company	New York	888,141 30	12,021 64	217,560 00	Nov. 22, 1932	*	*	*	261 65				286 88	67,413 55
3. Capital City Surety Company □	New York	1,022,240 00	168,151 96	327,222 84	Feb. 5, 1930								204,694 18	233,982 50
4. Equitable Casualty & Surety Company □	New York	3,291,313 75	2,577,822 65	3,330,349 06	Dec. 31, 1930	$139,181 06	$1,382,823 63	O$864,173 51	122,286 40	89,271 26			*272,068 54	2,685,726 44
5. First Russian Insurance Company [U. S. Branch]	New York	1,688,677 73	14,585 47	275,164 96	Aug. 3, 1925	1,280,067 62	18,300,709 39	O$6,672,916 39	431,918 26	9,362 26				*1,157,989 60
6. Independent Mutual Casualty Insurance Corp. □	New York	488,268 79	27,333 49	464,435 32	Jan. 20, 1933	167,704 98	1,193,966 69	136,360 99	116,681 15	69,271 47	$47,333 51	100 with int.	336,815 36	357,162 10
7. Jefferson Auto Mutual Casualty Insurance Corp. □	New York	393,698 92	18,221 12	482,780 89	Dec. 24, 1931	200,856 77	3,230,957 79	O3,895,164 75	35,266 68	7,894 98			80,663 31	329,267 11
8. Mortgage Guaranty & Title Company of New York	New York	226,672 50		27,686 00	Feb. 20, 1933	401,916 00	11,757,284 96	O823,272 00	47,657 45	3,437 19			*186,663 00	*265,767 88
9. New Jersey Fidelity & Plate Glass Insurance Co.**	Newark	*213,267 14			June 20, 1932	*	*	*	11,455 62	586 43			43,533 00	*272,184 57
10. Southern Surety Company of New York **	New York	5,200,918 80	2,430,293 14	5,961,971 72	Mar. 22, 1932	*	*	*	17,289 46				*1,035,312 14	3,835,357 50
11. Union Mutual Casualty Insurance Corp.◇	New York	389,972 21	60,096 23	686,622 12	May 26, 1931	404,682 00	9,589,139 71	93,541 56	*123,537 84	2,234 00			126,973 11	265,871 20

□ — Reports on disallowed claims have been filed with Supreme Court, New York County.

◇ — First Report and Audit dated May 11, 1932 and Second Report on claims dated September 6, 1932, have been filed with Supreme Court, New York County.

O — Claims filed greatly in excess of possible actual liability of Company.

1-9 {G*, H*, I*} — Claims not adjudicated.

4 N*— Includes cash in banks $176,994.30 attached.

5 O*— Includes $100,000.00 U. S. Govt. Bonds deposited with State of Ohio.

8 {G*, H*, I*} — Claims not adjudicated.

8 N*— Includes trust funds amounting to $42,489.97.

8 O*— Includes mortgages amounting to $255,300.00 held as collateral under Guarantee Agreement.

9 **— Ancillary Proceeding.

9 C*— Represents book value of assets in New York State.

9 {G*, H*, I*} — Claims not adjudicated.

9 O*— Includes assets pledged to secure notes payable amounting to $56,463.75.

10 **— Claims filed aggregating approximately $111,000,000.00 which represents an amount greatly in excess of any possible liability of Company.

10 {G*, H*, I*} — Claims not adjudicated.

10 N*— Includes cash in banks $14,538.79 attached, also $127,597.00 in suspended banks.

11 J*— Includes expenses of Boston Receiver of $15,108.82.

THIS CHECK IS IN PAYMENT IN FULL OF THE WITHIN ACCOUNT AND THE PAYEE ACCEPTS IT AS SUCH BY ENDORSEMENT HEREON IF INCORRECT RETURN CHECK WITH MEMORANDUM OF EXCEPTION.

DATE	PARTICULARS	AMOUNT
	SALARY	

NEW YORK STATE INSURANCE DEPARTMENT
LIQUIDATION BUREAU

No 5451 NEW YORK, SEP 16 1982 19

PAY TO THE ORDER OF Edward McLaughlin $250.

R.A. BRENNAN ★★★★ 250 DOLLARS 00 CTS

To Bank of New York and Trust Company
1-1 48 Wall Street, New York, N.Y.

R. A. Brennan
CHIEF, LIQUIDATION BUREAU

EXHIBIT "C" TO STIPULATION

[fol. 23] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 80,484

EDWARD McLOUGHLIN, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Findings of Fact and Opinion—Promulgated August 19, 1936

Compensation received by petitioner as counsel in the Liquidation Bureau of the Insurance Department of the State of New York, which was paid from the assets of insurance companies, held, not exempt from Federal income tax.

Bernhard Knollenberg, Esq., and Joseph W. Wyatt, Esq., for the Petitioner.

James H. Yeatman, Esq., for the Respondent.

The taxes in controversy are income taxes for the calendar year 1932 in the amount of $224.09. On his return for the calendar year 1932 the petitioner reported a salary of $5,125 from the New York State Insurance Department, but claimed the amount to be exempt from Federal income tax. The respondent held the salary taxable, and determined the deficiency here in controversy. The issue is whether the petitioner is exempt from tax under the implied constitu-
[fol. 24] tional immunity of the instrumentalities of a state from taxation by the Federal Government.

FINDINGS OF FACT

The petitioner is an attorney at law. Prior to 1929 he was associated with a law firm in Brooklyn, New York, and was actively engaged in practice. In 1930 he was appointed by the superintendent of insurance of the State of New York to act as counsel in the liquidation bureau, a branch of the insurance department. He was employed there from the beginning of 1930 until August 2, 1933. During the year 1932 the liquidation bureau maintained three offices in New York City. The main office was in the New York State Building at 80 Center Street, where petitioner was employed during 1932, and there were two branch offices, one at 2 Lafayette Street and the other at 111 John Street,

New York, New York. The petitioner gave full time required of employees in the liquidation bureau, and his hours were from 9 a. m. to 5 p. m., the same as attaches of that bureau who were not engaged in legal work.

After severing connections with the law firm with which he was connected in 1929 petitioner received no further salary from the firm. He maintained office space in their offices and did a certain amount of personal legal work there, such as the preparation of wills, et cetera, all of which was accomplished out of his regular hours with the liquidation bureau. The members of the firm cooperated with him in handling his personal work and the fees received were [fol. 25] divided according to agreement. Petitioner's personal legal fees in 1932 amounted to $1,410 and his office expenses were $570. The greater part of such sum represented fees from matters commenced in 1929, prior to his association with the insurance department. None of the personal legal work that he obtained after becoming associated with the insurance department was the result, either directly or indirectly, of his connection with that department.

The liquidation bureau was created in 1909 and is now known as the "Bureau of Liquidations, Conservations and Rehabilitations." This change in designation occurred sometime in 1933 and was made to make the name of the bureau conform to the description of the title of article II, chapter 191, of the Insurance Laws of the State of New York, which went into effect on March 15, 1932. It will be hereinafter referred to as the bureau. The bureau was in the year 1932 and now is under the charge of a special deputy superintendent of insurance. Said deputy superintendent is a civil service employee of the State of New York, and his salary is paid directly by the state. The bureau also had in 1932 three assistant special deputy superintendents, attorneys working on legal matters, bookkeepers, stenographers, adjusters and accountants. At the beginning of 1932 the bureau had approximately 100 employees and at the end of 1932 the number had been increased to approximately 400, none of whom, with the exception of the special deputy superintendent in charge, were civil service employees. The number of employees varied according to the number of insurance companies under the bureau's jurisdiction.

[fol. 26] The general functions and duties of the bureau are as follows: Under the Insurance Laws of the State of New York the superintendent of insurance of that state may, on certain grounds, apply to the judicial authorities of the state for an order directing him to take over the assets of insurers doing business or in process of organization for the purpose of doing business in the state, for the purpose of liquidating, rehabilitating or conserving the business of such insurers. Upon an order directing rehabilitation, liquidation, or conservation being granted, all of the work necessary to accomplish any of these results is performed by the bureau. When an order is obtained directing the liquidation of an insurance company its charter is dissolved and no new business is transacted. The work of liquidation consists of adjudicating the claims of the creditors of the company, selling the real estate and the other assets, and attempting to collect premiums due. After all of the assets of a company have been realized upon, dividends are distributed pro rata to the claimants entitled under the laws of the State of New York to participate in the assets of a defunct insurance company. When an order is obtained directing the rehabilitation of an insurance company the bureau actively operates it (but conducts no new business) and takes steps to remove the causes and conditions which made such proceeding necessary in an effort to bring about its rehabilitation and place the company in a sound financial condition. If the bureau succeeds in rehabilitating the insurer, the assets are turned back to it and it resumes operations under its own direction. If and when it is determined that further efforts to rehabilitate a com-[fol. 27] pany will be futile, the superintendent of insurance may apply for an order of liquidation. No rehabilitation work was done by the petitioner or the bureau in 1932. Although the superintendent of insurance was authorized to apply for rehabilitation orders, no such order was applied for until the year 1933. Upon taking charge of a company for liquidation purposes, certain of the staff of the company such as underwriters and the so-called "production staff" would be dismissed. The key employees would be retained, and the remainder dismissed as soon as practicable. It was the policy of the bureau to centralize the liquidation work as much as possible in one office. The procedure would necessarily vary according to the size of

the companies placed in liquidation, etc. In the case of a very large company its affairs could not be transferred to another office for a long period of time. At the beginning of 1932 the bureau was liquidating 39 insurance companies; at the end of 1932 it was liquidating 11 companies.

In legal matters involving companies in liquidation, the petitioner appeared as the attorney of record. He devoted over 90 per cent. of his time during 1932 to legal problems and cases involving the companies in liquidation whose affairs were being administered at the 80 Center Street office. The balance of his time was devoted to legal problems of the bureau as a whole, such as the drafting of a new article XI of the Insurance Law.

In the year 1932 the department of insurance had a general bank account with the Bank of New York & Trust Co. at 48 Wall Street, New York City. The expenses of the [fol. 28] bureau, including all salaries, were paid by checks drawn on this bank. This account was referred to as the "Wash Account," as simultaneously with the drawing of checks for salaries, etc., other checks were drawn on the bank accounts of the companies in liquidation and deposited with the Bank of New York & Trust Co. to equalize the amount drawn out therefrom to meet the salaries and other overhead expenses of the bureau. In drawing checks against the various companies in liquidation to meet petitioner's compensation and the other expenses of the bureau, checks would be drawn by an assistant special deputy of insurance (as representative of the superintendent of insurance) on the bank accounts in which the deposits of the various companies were maintained. Each company coming under the jurisdiction of the bureau kept its separate bank account, and the superintendent of insurance (having charge of all the assets of such company) was in a position to draw checks on the account.

Petitioner's compensation for 1932 was prorated to the companies in proportion to the time devoted by him in connection with the respective companies on the legal affairs of which he was engaged. Petitioner's time devoted — the affairs of one particular company would be charged against such company. Petitioner's time devoted to the general legal problems of the department would be prorated among the various companies under a formula designed to charge general administration expenses of the department to the

companies in liquidation in proportion to the aggregate [fol. 29] compensation of those engaged in the specific liquidation of the respective companies.

Petitioner's compensation during 1932 was paid bimonthly by check, but was computed on an annual basis. Petitioner did not receive any additional compensation from the insurance department by way of special fees or otherwise in addition to his fixed compensation. His yearly compensation was determined by the superintendent and the compensation did not vary in accordance with the volume of legal matters handled by him during the year. Petitioner's entire compensation for 1932 was paid from funds of insurance companies being liquidated by the superintendent of insurance.

In the budget of the superintendent of insurance there appeared an item called the reserve fund, for the use of the superintendent in liquidating insurance companies whose assets were not sufficient to pay the cost of liquidation. In the budgets submitted for the fiscal years ending June 30, 1931, 1932 and 1933, the amount of the reserve fund was $5,000. It does not appear that any of the compensation paid to the petitioner during the year 1932 was derived from this fund.

Opinion

ARUNDELL:

This proceeding is in all material respects like that of Clarence M. Freedman, 34 B. T. A. (No. 146), decided this day. The arguments of the parties are along the same lines in both cases and it is unnecessary in this case to repeat our views on the several points urged. It is sufficient to say briefly in this case, as we said at length in the other, [fol. 30] that we are not satisfied that petitioner can be classified as an employee of the state engaged in carrying on an essential governmental function and that in any event the fact of his compensation being from private funds and not from those of the state precludes the allowance of exemption from Federal income tax.

Decision will be entered for the respondent.

BEFORE UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 80,484

EDWARD McLOUGHLIN, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DECISION

Pursuant to the determination of the Board, as set forth in its report promulgated August 19, 1936, it is

Ordered and Decided: That there is a deficiency in income tax for the year 1932 in the amount of $224.09.

Enter:

Entered August 21, 1936.

(Signed) C. Rogers Arundell, Member. (Seal.)

[fol. 31] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

[Title omitted]

PETITION FOR REVIEW—Filed October 13, 1936

The above named petitioner hereby petitions for a review of the decision of the United States Board of Tax Appeals entered on August 21, 1936 which approved deficiencies in income tax for the year 1932 in the amount of $224.09.

I

Statement of the Nature of the Controversy

Petitioner, a United States citizen, resides in Brooklyn, New York, and filed his income tax return for 1932, with the Collector of Internal Revenue for the First District of New York, whose office is located in Brooklyn, New York. The office of said Collector is located within the jurisdiction of this Court.

On or about March 15, 1935, respondent mailed to the petitioner a notice of deficiency dated on said date for the [fol. 32] year 1932 in the amount of $224.09. Thereafter, and within the period of ninety (90) days from March 15, 1935, petitioner filed a petition for a redetermination of the said deficiency.

The facts were stipulated and on August 19, 1936, the

Board promulgated its opinion in favor of the respondent, the order affirming the deficiency being entered on August 21, 1936. A petition for rehearing and/or reconsideration was denied without opinion September 24, 1936. From the said order and decision, petitioner is appealing to this Court.

The nature of the controversy is as follows:

During the taxable year involved, petitioner was an employee of the Insurance Department of the State of New York, the head of which is the Superintendent of Insurance, a state office created by statute. Petitioner, a lawyer by profession, worked in the Liquidation Bureau, a branch of the Insurance Department, and devoted the full time required of all employees in this Department, his hours being from 9 A. M. to 5 P. M. He received a fixed salary and his remuneration did not depend upon the amount of work he handled in the Legal Department of the Bureau. Petitioner had been connected with a law firm in the year 1929 and subsequent to that date received no further salary from such firm. In 1929, he was appointed Secretary to the then Superintendent of Insurance and in 1930 was requested by the Superintendent of Insurance to act as counsel in the Liquidation Bureau. His employment was pursuant to the statutory authority of the Superintendent of Insurance to [fol. 33] appoint deputies, employ counsel, clerks and assistants. Petitioner, subsequent to such appointment in 1930 and throughout the taxable year, was employed in the Legal Department of the Liquidation Bureau and devoted over 90% of his time to legal problems and cases involving the companies in liquidation whose affairs were being administered by the office of the Bureau located at 80 Center Street, New York City. The balance of his time was devoted to the legal problems of the Bureau as a whole, such as the drafting of a new article of the Insurance Law which became effective in March, 1932.

In the taxable year involved, petitioner received personal legal fees amounting to $1,410 against office expenses of $570. He retained office space with his law firm during the taxable year and did a certain amount of personal legal work, such as the preparation of wills, etc., all of which was accomplished out of his regular hours. In doing such personal work, petitioner got the assistance of one of the members of the law firm to handle or cooperate in the work and the fees were divided according to a mutual agreement with such individual.

The Liquidation Bureau of the New York Insurance Department was created pursuant to statute in 1909 and since some date in 1933 has been known as the Bureau of Liquidations, Conservations and Rehabilitations. The Bureau in the year 1932 (and today) was in charge of a Special Deputy Superintendent of Insurance, a Civil Service employee whose salary is paid directly by the State. Under the New York Insurance Law, when a court order is obtained directing the liquidation of an insurance com- [fol. 34] pany, its charter is dissolved and no new business is transacted.

Petitioner's compensation for the year 1932 was pro rated to the companies in liquidation proportioned to the time devoted by him in connection with such respective companies.

The deficiency in question results from the respondent's ruling that the amount of petitioner's salary received as an employee of the Insurance Department was subject to tax as not being within the constitutional exemption covering state officers and employees. The Board sustained the Commissioner's ruling on this point.

II

Designation of Court of Review

The petitioner resides within jurisdiction of this Court and desires a review in accordance with the provisions of the Revenue Act of 1932.

III

Assignments of Error

Petitioner, as a basis for review, makes the following assignments of error:

1. The Board of Tax Appeals erred in holding:

(a) That petitioner's salary of $5,125 was subject to Federal income tax for the year 1932.

(b) That the Federal Government had the power to tax petitioner's salary received for his services as an employee [fol. 35] of the New York State Insurance Department.

2. The Board of Tax Appeals erred in failing to find as a fact that:

(a) Petitioner was an employee of the State of New York, as distinguished from an independent contractor.

3. The Board of Tax Appeals erred in failing to find from the evidence:

(a) That the Liquidation Bureau of the New York Insurance Department was performing in the year 1932 an essential Governmental function.

(b) That petitioner's services as an employee of the Insurance Department were devoted to carrying out an essential or sovereign function of the State of New York.

4. The Board of Tax Appeals erred in determining the deficiency as aforesaid and in failing to determine there was no deficiency for the taxable year involved.

Wherefore, your petitioner prays that the United States Circuit Court of Appeals for the Second Circuit may review the said decision, opinion, and order and reverse and set aside the same and that the Clerk of the United States Board of Tax Appeals be directed to transmit and deliver to the Clerk of the said court certified copies of all and every [fol. 36] of the documents necessary and material to the presentation and consideration of the foregoing petition for review, as required by the rulings of said court and statutes made and provided.

Bernhard Knollenberg, Attorney for Petitioner, No. 25 Broadway, New York, N. Y.

Duly sworn to by Bernhard Knollenberg. Jurat omitted in printing.

[fol. 37] BEFORE UNITED STATES BOARD OF TAX APPEALS

[Title omitted]

PRÆCIPE FOR RECORD—Filed October 13, 1936

To the Clerk of the United States Board of Tax Appeals:

You will please prepare and, within sixty days from the date of the filing of the petition for review in the above entitled case, transmit to the Clerk of the United States Circuit

Court of Appeals for the Second Circuit certified copy of the following documents:

(1) The docket entries of proceedings before the United States Board of Tax Appeals in the case above entitled.
(2) Pleadings before the Board.
(3) Findings of Fact, Opinion and Decision of the Board.
(4) Petition for Review.
[fol. 38] (5) Stipulation of Facts filed herein on October 28, 1935, and Exhibits A, B and C, attached thereto.

The foregoing to be prepared, certified and transmitted, as required by law and the rules of the United States Circuit Court of Appeals for the Second Circuit.

Bernhard Knollenberg, Attorney for Edward McLoughlin.

October 13, 1936.

[fol. 39] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 40] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

EDWARD McLOUGHLIN, Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

Before L. Hand, Swan and Augustus N. Hand, Circuit Judges

Appeal from the United States Board of Tax Appeals

Petition of Edward McLoughlin, a taxpayer, to review an order of the Board of Tax Appeals determining a deficiency of $224.09 in his income taxes for the year 1932. Order affirmed.

Lord, Day & Lord, Attorneys for Petitioner Edward McLoughlin; Bernhard Knollenberg, Jesse Hoyt and Joseph W. Wyatt, Counsel.

James W. Morris, Assistant Attorney General of the United States, Sewall Key and Berryman Green, Special Assistants to the Attorney General, for Respondent.

John J. Bennett, Jr., Attorney General of the State of New York, Henry Epstein, Solicitor-General, and John F. X. McGohey, Colin McLennan and John C. Crary, Assistant Attorneys General, Amici Curiæ.

[fol. 41] AUGUSTUS N. HAND, Circuit Judge:

This is a petition by a taxpayer employed in the Insurance Department of the State of New York at an annual salary of $5,125 to review an order of the Board of Tax Appeals holding his salary for 1932 income subject to taxation under the Revenue Act of that year. In 1930 the taxpayer was appointed by the Superintendent of Insurance to act as legal counsel in the Liquidation Bureau of the Insurance Department and worked daily in that capacity from 9 A. M. to 5 P. M. Outside of these office hours he did a certain amount of legal work for personal clients which, in 1932, yielded $1,410 less $570 office expenses.

The liquidation Bureau was created in 1909 and in 1932 was in charge of a Special Deputy Superintendent of In-

surance who was a civil service employee with a salary paid by the State. During the year 1932 the Bureau had from 100 to 400 employes, including three Assistant Special Deputy Superintendents, attorneys working on legal matters, bookkeepers, stenographers, adjusters and accountants.

Under the New York Insurance Law the Superintendent of Insurance may apply to the court for an order taking over the assets of insurance companies for the purpose of liquidating, rehabilitating or conserving their business. When such an order is made all of the work necessary for liquidation, rehabilitation or conservation is performed by the Bureau. When an order for liquidation of a company is made, its charter is dissolved and no new business is transacted but the assets are liquidated, the claims of creditors adjudicated and dividends are declared to those persons entitled to share in the assets of a defunct insurance com- [fol. 42] pany. When a company is rehabilitated by the Bureau its property is returned to it so that it may resume business under its own management.

The business of the Bureau during 1932 was liquidation to which the taxpayer devoted 90% of his time during that year. The remaining 10% was devoted to legal problems of the Bureau as a whole, such as drafting a new Article XI of the Insurance Law relating to "Rehabilitation, Conservation and Dissolution of Delinquent Insurers."

Among the facts stipulated before the Board of Tax Appeals were the following:

"8. In the year 1932 the Department of Insurance had a general bank account with the Bank of New York & Trust Company at 48 Wall Street, New York City. The expenses of the Bureau, including all salaries, were paid by checks drawn on this bank. This account was referred to as the "Wash Account," as simultaneously with the drawing of checks for salaries, etc., other checks were drawn on the bank accounts of the companies in liquidation and deposited with the Bank of New York & Trust Company to equalize the amount drawn out therefrom to meet the salaries and other overhead expenses of the Bureau. In drawing checks against the various companies in liquidation to meet petitioner's compensation and the other expenses of the Bureau, checks would be drawn by an Assistant Special Deputy of Insurance (as representative of the Superintendent of Insurance) on the bank accounts in which the deposits of the

various companies were maintained. Each company coming under the jurisdiction of the Bureau kept its separate bank account, and the Superintendent of Insurance (having [fol. 43] charge of all the assets of such company) was in a position to draw checks on the account.

"9. Petitioner's compensation for 1932 was prorated to the companies in proportion to the time devoted by him in connection with the respective companies on the legal affairs of which he was engaged. Petitioner's time devoted to the affairs of one particular company, would be charged against such company. Petitioner's time devoted to the general legal problems of the Department, would be prorated among the various companies under a formula designed to charge general administration expenses of the Department to the companies in liquidation in proportion to the aggregate compensation of those engaged in the specific liquidation of the respective companies.

"10. Petitioner's compensation during 1932 was paid bi-monthly but was computed on an annual basis. Petitioner was paid by check, a form of the check used being annexed hereto as Exhibit 'C'. Petitioner did not receive any additional compensation from the Insurance Department by way of special fees or otherwise in addition to his fixed compensation. His yearly compensation was determined by the Superintendent and the compensation did not vary in accordance with the volume of legal matters handled by him during the year. Petitioner's entire compensation for 1932 was paid from funds of insurance companies being liquidated by the Superintendent of Insurance.

"11. In the budget of the Superintendent of Insurance there appeared an item called the Reserve Fund, for the [fol. 44] use of the Superintendent in liquidating insurance companies whose assets were not sufficient to pay the costs of liquidation. In the budgets submitted for the fiscal years ending June 30, 1931, 1932 and 1933, the amount of the Reserve Fund was $5,000.00. It does not appear that any of the compensation paid to the petitioner during the year 1932 was derived from this fund."

The salary the taxpayer received for his work in the Liquidation Bureau was held taxable by the Commissioner of Internal Revenue. The action of the Commissioner was

sustained by the Board of Tax Appeals on the ground that the taxpayer was not "an employee of the state engaged in carrying on an essential governmental function and that in any event the fact of his compensation being from private funds and not from those of the state precludes the allowance of exemption from Federal income tax."

The question presented for our decision is whether the taxpayer's compensation as counsel for the Liquidation Bureau and received through such Bureau is subject to federal income tax.

Section 22 of the Revenue Act of 1932 provides that:

"(a) *General Definition.*—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind in whatever form paid, * * *."

Treasury Regulations 77 contained the following provisions:

"Art. 643. *Compensation of State Officers and employees.*—Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered [fol. 45] in connection with the exercise of an essential governmental function of the State or political subdivision, including fees received by notaries public commissioned by States, is not taxable. Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (a) the person receives such compensation as an officer or employee of a State or political subdivision, and (b) the services are rendered in connection with the exercise of an essential governmental function. The commissions of receivers appointed by State courts are taxable."

It is unnecessary for us to deal with the question as to whether the taxpayer when acting as counsel for the Liquidating Bureau was engaged by the State in the exercise of essential governmental powers. It may well be that his activities were essential, like those of a receiver. Jacoby v. Bond & Mortgage Guarantee Co., 72 F. (2d) 420, 423. Irrespective of any such relation to the State there can be no exemption from federal taxation where, as here, taxation would result in no burden upon the governmental power of the State. That the existence of a burden is the test

was the view adopted by the Supreme Court in sustaining the validity of a transfer tax by a State upon United States bonds in Plummer v. Coler, 178 U. S. 115, and in upholding a federal tax upon an estate which included State municipal bonds in Greiner v. Lewellyn, 258 U. S. 384. See also [fol. 46] Snyder v. Bettman, 190 U. S. 249, 253, 254; United States v. Perkins, 163 U. S. 625, and Fox Film Corp. v. Doyal, 286 U. S. 123, 128. By the same reasoning it was held that profits realized by an investor from a sale of municipal bonds were properly taxed under the Revenue Act of 1924, Willcuts v. Bunn, 282 U. S. 216, and that a non-discriminatory privilege tax by the State of Georgia on the business of licensing copyrighted motion pictures was lawful. Fox Film Corp. v. Doyal, 286 U. S. 123. In his opinion in Willcuts v. Bunn, Hughes, C. J., said:

"The limitation of this principle to its appropriate applications is also important to the successful working of our governmental system. The power to tax is no less essential than the power to borrow money, and, in preserving the latter, it is not necessary to cripple the former by extending the constitutional exemption from taxation to those subjects which fall within the general application of non-discriminatory laws, and where no direct burden is laid upon the governmental instrumentality, and there is only a remote, if any, influence upon the exercise of the functions of government."

In the case at bar the State in the exercise of its police power is merely using its governmental facilities without expense to itself to aid a private corporation in liquidating insolvent insurance companies in the same way in which chancery receivers or statutory receivers were formerly employed. It is clearly subjected to no burden in any exercise of its sovereignty.

Counsel for the appellant argues, however, that the only situation where the question of a burden upon the public [fol. 47] treasury becomes a relevant factor in determining whether there is a tax exemption is where an independent contractor is employed by governmental authority, such as the consulting engineer engaged by a state as to projects for water supply and sewage disposal whose salary was held taxable in Metcalf & Eddy v. Mitchell, 269 U. S. 514. But no such limitation of the field in which exemptions are

granted because the tax is not a burden is justifiable. The origin of such exemptions is found in the statements of Marshall, C. J., in a case where state taxation of national banks was involved, that "the power to tax involves the power to destroy", and that there is "no power, by taxation or otherwise, to retard, impede, burden, or in any manner to control, the operations of the constitutional laws enacted by Congress to carry into execution the powers vested in the general government." McCulloch v. Maryland, 4 Wheat. 316, 431, 436. Whatever may be the justification for applying such a rule to taxes which are discriminatory the reason ceases if, as here, the tax in question is ex hypothesi not a burden upon the public treasury. The remote possibility that a tax may affect a state or the United States is not enough to create an exemption. Burnet v. A. T. Jergins Trust, 288 U. S. 508; Greiner v. Lewellyn, 258 U. S. 384; Baltimore Shipbuilding Co. v. Baltimore, 195 U. S. 375; Snyder v. Bettman, 190 U. S. 249; Plummer v. Coler, 178 U. S. 115; United States v. Perkins, 163 U. S. 625; Railroad Company v. Peniston, 18 Wall. 5; National Bank v. Commonwealth, 9 Wall. 353; Thomson v. Pacific Railroad, 9 Wall. 579; Veazie Bank v. Fenno, 8 Wall. 533.

The situations in which exemption from taxation has [fol. 48] not been allowed are: (1) where a State has departed from its usual governmental functions and engaged in business enterprises for the public benefit, Helvering v. Powers, 293 U. S. 214; Ohio v. Helvering, 292 U. S. 360; South Carolina v. United States, 199 U. S. 437; (2) where persons subjected to taxation are neither officers nor regular employes of the State, but are so-called independent contractors, Metcalf & Eddy v. Mitchell, 269 U. S. 514.

We think the justification for denying exemption in each category is that the tax imposes no real burden upon, or impediment to a normal exercise of sovereign power. There will be differences of opinion as to the extent of protection needed against the aggressions of one governmental unit upon another, but there can be no warrant for allowing exemption from a tax which does not burden or impede the exercise of any governmental function.

We find no decisions by the Supreme Court which indicate that employes who receive their compensation from

the avails of a privately owned corporation that is being liquidated by the State are exempt from taxation. On the contrary the recognition of such an exemption would seem to withdraw income from taxation under a fanciful theory of sovereign immunity entirely inapplicable to a federal system of government. Indeed the general allowance of exemptions in similar situations might easily exhaust large sources of income in times of financial depression.

It is argued that our views are contrary to the recent decisions of the Supreme Court in New York ex rel. Rogers v. Graves, 299 U. S. —, and Brush v. Commissioner, — U. S. —. In the first case the salary of the general counsel for the Panama Railroad Company was held exempt from taxation on the ground that the company was a wholly [fol. 49] owned instrumentality of the United States "engaged in maintaining, operating and protecting the Panama Canal." It was said by Sutherland, J., writing for the court, that: "The primary purpose of the enterprise being legitimately governmental, its incidental use for private purposes affords no ground for objection." In the second case the salary of the chief engineer of the Bureau of Water Supply of New York City, appointed under statutory authority with a fixed annual salary of $14,000, was held to be immune from federal income tax because the city in supplying water was exercising an essential governmental function. In each instance it could properly be said that, within the old rule, there was a burden upon a governmental enterprise and not, as here, a taxation of the salary of a State employee engaged in liquidating a private corporation and paid out of its property.

Other decisions strongly relied on by the appellant are Therrell v. Commissioner, 88 Fed. (2d) — (C. C. A. 5), and Hoskins v. Commissioner, 84 Fed. (2d) 627 (C. C. A. 5). In the Therrell case the question was whether bank liquidators who were appointed by the Comptroller of the State of Florida to take charge of the assets of insolvent banks and were subject to dismissal by him, and whose compensation was to be fixed by him at an amount not exceeding 5% of the cash collected, were subject to taxation. A majority of the court held that the salary of such a liquidator was not subject to tax by the federal government because he was an instrumentality appointed

by the State to aid in the administration of its banking laws and to do justice to those interested in an insolvent bank. Judge Hutcheson dissented on the ground that the liquidator was not an officer of the State and drew no [fol. 50] salary therefrom and that: "He merely undertakes for and under the appointment of a Comptroller, as a court receiver does for and under the appointment of a court, to handle specific matters of conservation and liquidation when appointed to do so." Any distinction between the Therrell decision and the case at bar is tenuous but, with all respect, we feel obliged to differ with the decision of the majority.

In the Hoskins case a school district operated a cafeteria for the benefit of its pupils and teachers who alone were allowed to patronize it and were required to pay for food but only at cost. The compensation of the person managing the cafetria was held free from federal taxation for the reason that such taxation would be an interference with a state governmental function. If this decision can be justified it must be only on the theory that a cafeteria was part of the total expense of the district and that the salary of the taxpayer, though payable out of the receipts of the cafeteria, was not to be allocated to that source.

We do not suggest that the Supreme Court would hold that because a State official received his compensation out of fees a federal tax upon it would not be an interference with a State function. But whatever may be said of some situations where compensation is not derived directly from the public treasury we are persuaded that a liquidating agent paid wholly out of the property of an insolvent is not entitled to exemption.

Order affirmed.

[fol. 50½] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Edward McLoughlin against Commissioner of Internal Revenue. Opinion. Augustus N. Hand, C. J.

[fol. 51] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a stated term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States Court House in the City of New York, on the 10th day of May, one thousand nine hundred and thirty-seven.

Present: Hon. Learned Hand, Hon. Thomas W. Swan, Hon. Augustus N. Hand, Circuit Judges.

EDWARD McLOUGHLIN, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be and it hereby is affirmed.

It is further ordered that a mandate issue to the said Board in accordance with this decree.

Wm. Parkin, Clerk.

[fol. 52] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Edward McLoughlin vs. Commissioner of Internal Revenue. Order for mandate. United States Circuit Court of Appeals, Second Circuit. Filed May 10, 1937. William Parkin, Clerk.

[fol. 53] UNITED STATES OF AMERICA,
Southern District of New York:

I, William Parkin, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 52, inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of Edward McLoughlin, Petitioner, against Commissioner of Internal

Revenue, Respondent, as the same remain of record and on file in my office.

In Testimony Whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this tenth day of May, in the year of our Lord one thousand nine hundred and thirty-seven, and of the Independence of the said United States the one hundred and sixty-first.

Wm. Parkin, Clerk. (Seal United States Circuit Court of Appeals, Second Circuit.)

[fol. 54] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 11, 1937

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted, and the case is assigned for hearing immediately following No. 129.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Black took no part in the consideration and decision of this application.

Endorsed on cover: File No. 41,768. U. S. Circuit Court of Appeals, Second Circuit. Term No. 287. Edward McLoughlin, petitioner, vs. Commissioner of Internal Revenue. Petition for a writ of certiorari and exhibit thereto. Filed August 5, 1937. Term No. 287, O. T., 1937.